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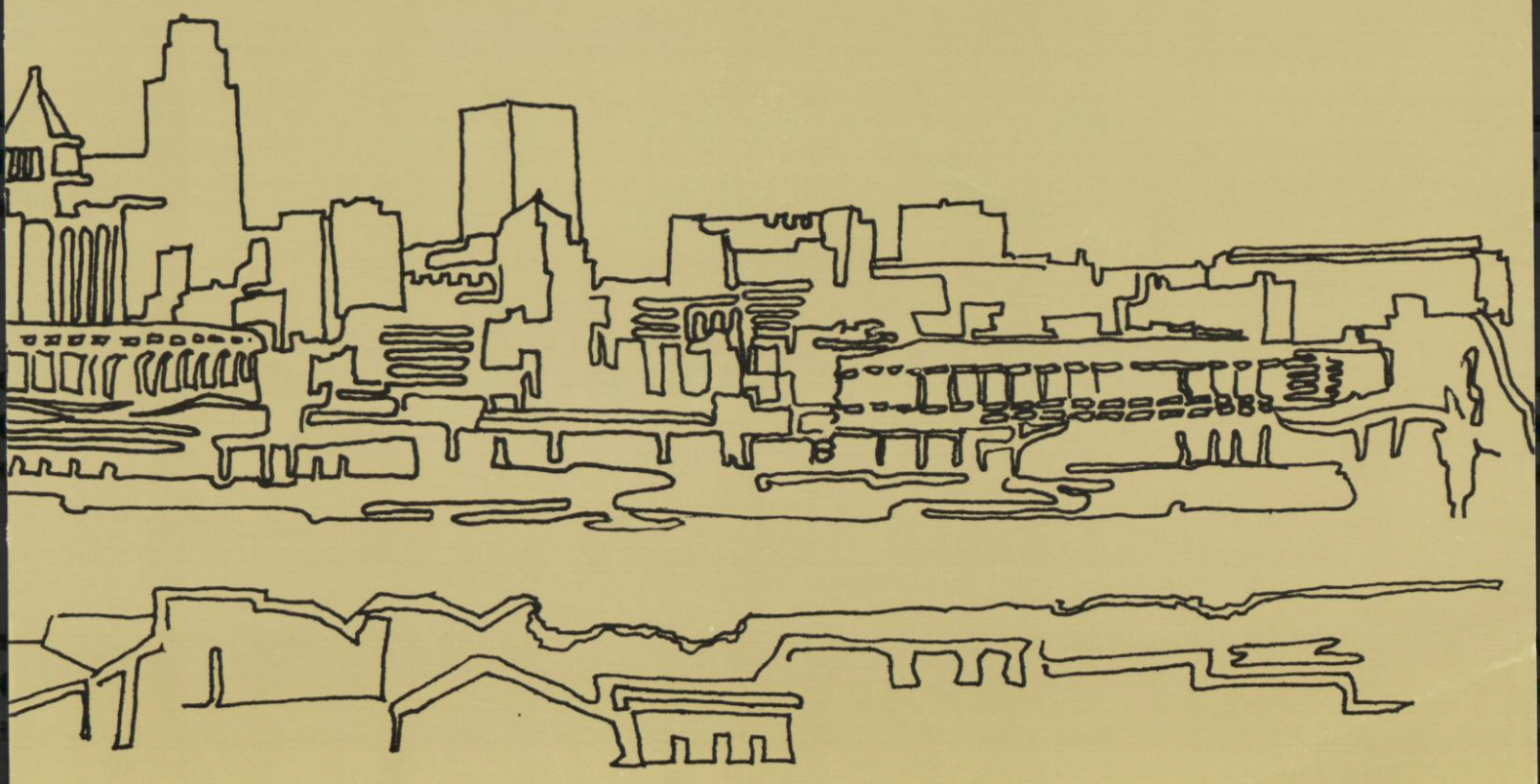
Cincinnati Bell Inc.
Annual Report
1976



Annual report to share owners

Dear Share Owner:

The earnings decline we experienced in 1975 was halted during the past year. 1976 earnings per common share were $2.79, up three cents from the preceding year. The turn-around was accomplished by the dedicated efforts of employees to control costs and increase sales, aided by the application of automated controlling and managing systems which improved accuracy and productivity. Throughout the year the quality of customer service remained as good as at any time in our history.

Total operating revenues for the year were 8.8 percent higher than 1975 revenues. Contributing to the increase were growth in the number of customers served and growth in use of the services we provide. A repricing of interstate long distance service in February, and of Ohio intrastate service in August, also favorably affected operating revenues.

The operating expense increase was held to within less than a percentage point of the increase in revenues. Expenses increased 9.2 percent over the preceding year, mostly attributable to increases in employee compensation. The wage increase in August was the final one in a three-year labor agreement reached in August 1974. The remainder of the increase in operating expense was caused principally by higher costs of goods and services we purchased.

There has been progress in our pending applications to reprice services, which we filed in November 1975. We anticipate the resolution of our rate cases in 1977, with a resulting positive effect on overall earnings.

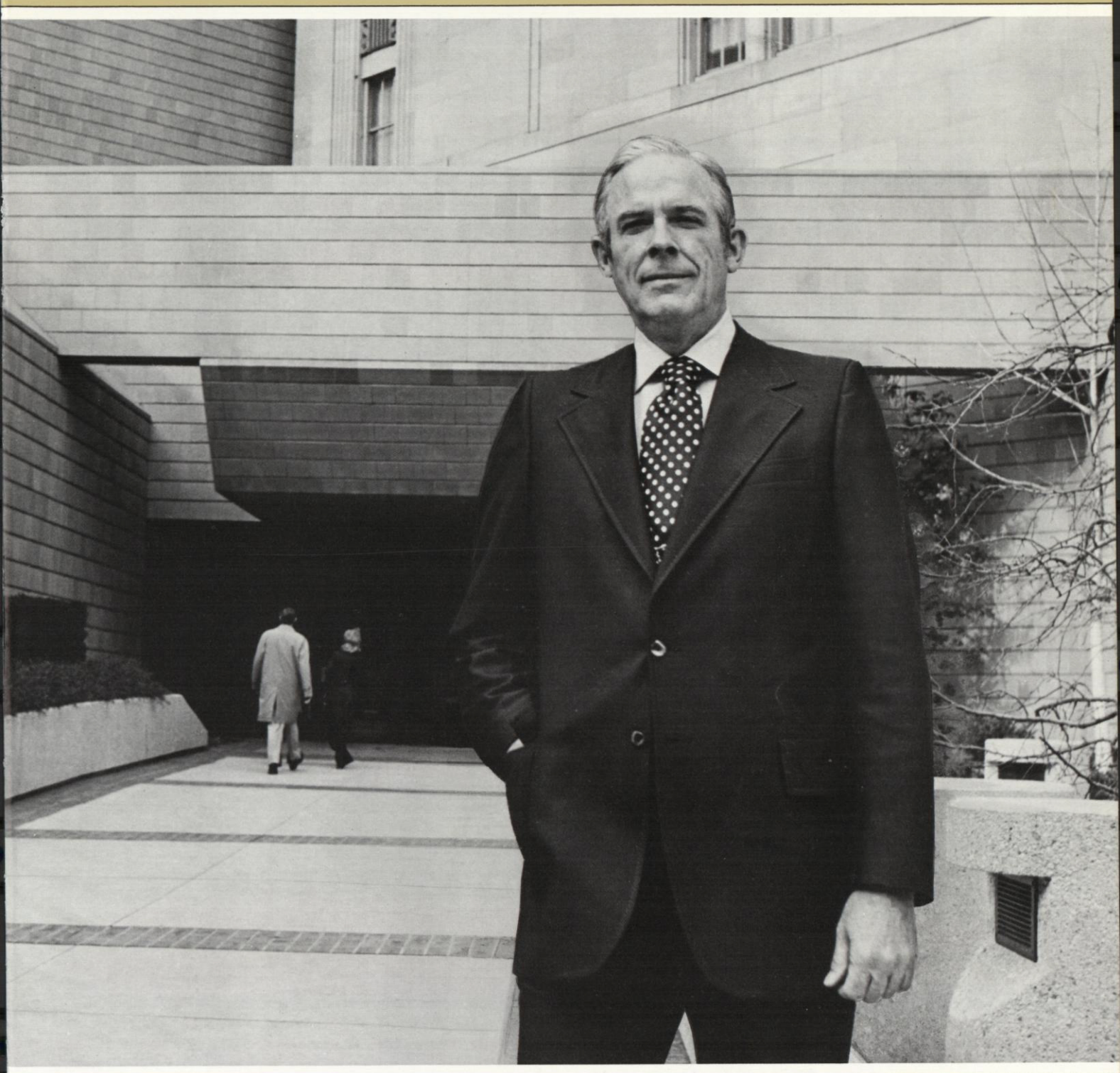
We remain committed to maintaining service quality at high levels, and to enhancing the investment of Cincinnati Bell share owners.

A review of Cincinnati Bell's 1976 performance is on the succeeding pages.

R. T. Dugan

February 25, 1977

The Annual Meeting of the Share Owners will be held at 12 Noon on Monday, April 18, 1977 at our 229 West Seventh Street Building Cincinnati, Ohio 45202



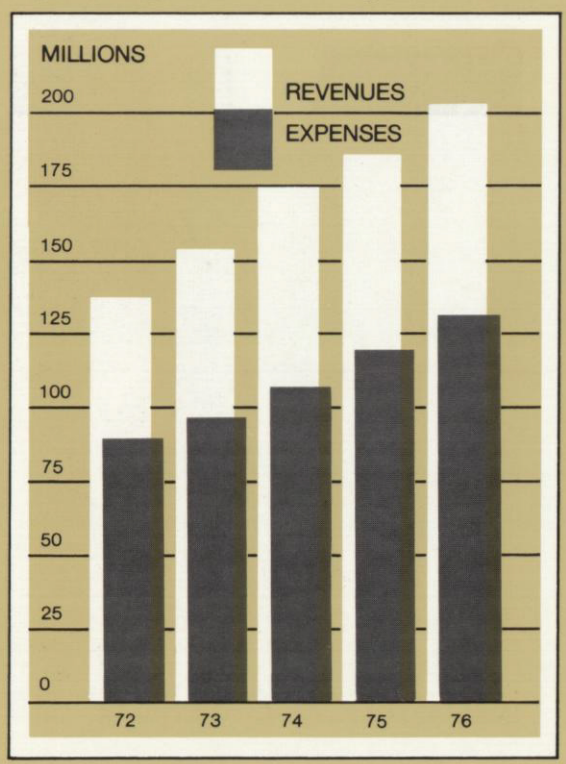
Inquiries concerning the Share Owner Dividend Reinvestment and Stock Purchase Plan, and requests for Cincinnati Bell's annual report to the Securities and Exchange Commission, Form 10-K, should be directed to R. H. Allen, Secretary, Cincinnati Bell Inc., 225 East Fourth Street, Cincinnati, Ohio 45202.

Line Of Business: Cincinnati Bell is engaged in the business of furnishing communications services, mainly local and toll telephone services, in parts of Ohio, Kentucky and Indiana.

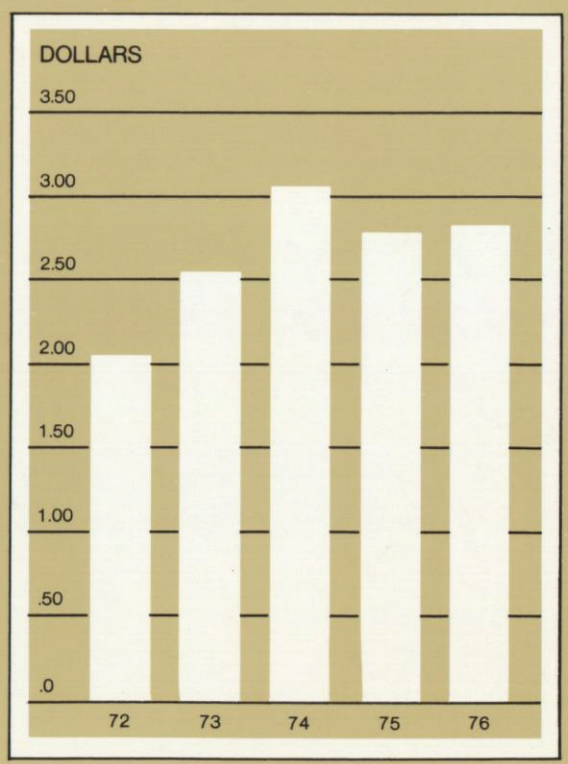
Highlights - The year 1976

	1976	1975
Operating Revenues	$200,233,000	$184,109,000
Operating Expenses	$129,554,000	$118,628,000
Operating Taxes	$ 36,240,000	$ 33,745,000
Interest Deductions	$ 12,985,000	$ 11,890,000
Income Applicable to Common Shares	$ 19,544,000	$ 19,349,000
Earnings Per Common Share	$2.79	$2.76
Dividends Declared Per Common Share	$1.60	$1.60
Number of Common Share Owners	18,567	18,759
Telephones in Service	1,079,359	1,034,508
Long Distance Messages	52,317,000	48,141,000
Construction Expenditures	$ 55,570,000	$ 55,092,000

Operating revenues/expenses



Earnings per common share



Operations

The increase in operating revenues of 8.8 percent over 1975 compares favorably with the 5.4 percent increase of 1975 over 1974. Operating expenses were up 9.2 percent, significantly better than the 11.6 percent increase last year. This combination of efforts resulted in an earnings increase to $2.79 per common share, up three cents over 1975.

The number of telephones in service at year end was 1,079,359, up 4.3 percent for the year. Growth the previous year was 3.1 percent. Approximately 52.3 million originating long distance messages, and over two billion local calls were processed, increases of 8.7 percent and 3.6 percent respectively.

Internal measurements and periodic external surveys both indicate that all phases of customer service were excellent. For the fifth consecutive year, there were no "weakspots," or service measurements below the acceptable levels as reported to the Federal Communications Commission.

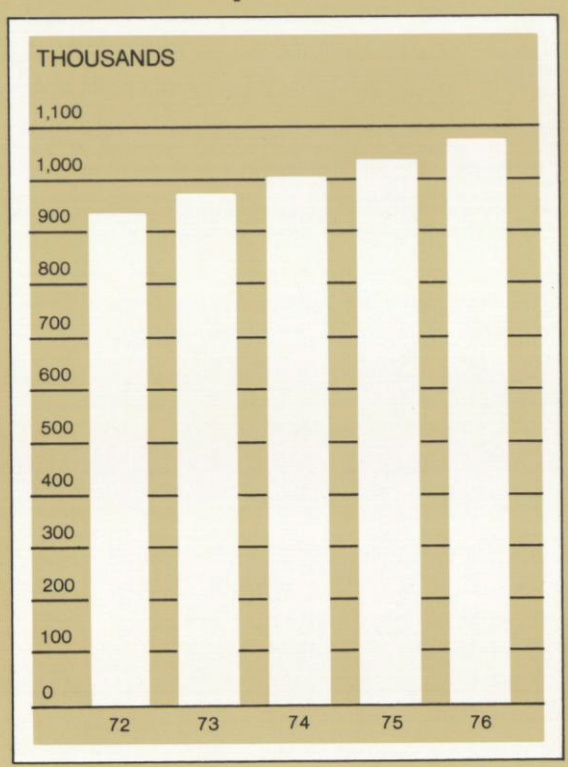
Productivity levels in the telephone industry are measured in part by the number of employees per 10,000 telephones. For Cincinnati Bell, this measurement has improved by about 26 percent over the past five years.

In large part, those gains have been made possible through the application of new methods and new technology, such as electronic switching.

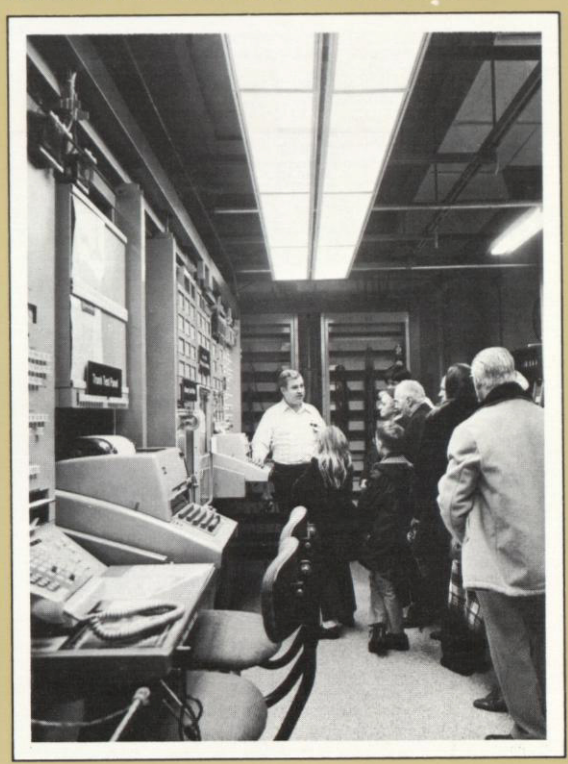
One such 1976 application, introduced after years of preparation, was the Customer Records Information System. The system simplifies the maintaining, editing and updating of customer records, relieving business office personnel of many time-consuming clerical functions.

Another application to improve productivity and meet continued growth was the conversion of two repair bureaus to faster, easier-to-operate cordless test consoles. The consoles replaced old switchboard-type positions.

Number of telephones



An estimated 1,100 people attended four open houses held in 1976 to demonstrate to area residents how their calls are switched.



The Customer Record Information System uses a Computer Display Terminal to feed information to the computer memory bank. The managers overseeing the introduction of CRIS were, seated, Norm Breines; and standing, left to right, Bill Stewart, Charlie Jackson, Eileen Conway, Muriel Wallace and Debbie Disch.

A new inventory control system for plug-in circuit equipment became fully operational in 1976, and resulted in a savings of $368,000 for the year. We expect similar savings in the years ahead.

Capital expenditures to expand, modernize and replace equipment and facilities amounted to $55.6 million in 1976.

Marketing

Several new service offerings, a succession of sales drives, a new residence service promotion called Phone Parties and a departmental reorganization highlighted effective marketing efforts during 1976.

The new services include the electronic Dimension* PBX which uses solid-state technology and a miniaturized computer to provide a wide range of service features. Service features can be added or changed easily and quickly to accommodate the changing needs of customers. Some of the features of the Dimension include adding a third person to your call; having a call forwarded when you're away from your phone; priority queuing when all outgoing lines are busy with automatic callback when a line is free; and distinctive ringing to let you know if the call is an outside, inside, or special feature call.

Another new service is Touch-A-Matic® 16, an automatic dialing telephone designed primarily for residence customers. At the touch of a button, any of 15 pre-selected numbers, including emergency numbers, can be dialed. The 16th button automatically re-dials the last number dialed manually.

The series of sales drives conducted during the year were principally in the residence market. The campaigns featured

additions to basic service and resulted in added annual revenues of nearly $700,000.

At a Phone Party, an informal gathering of residence customers at the home of a volunteer hostess, a Cincinnati Bell manager displays and explains the advantages of a wide array of Design Line* telephones and Custom Calling Services. After the demonstration, orders are taken on the spot. In some cases, customers can take the telephone home with them. Eighty-four parties were held during 1976, and brought in more than $12,000 in annual revenue.

To anticipate the changing needs of customers and to respond more effectively to their demands for specialized services, the Marketing Department was reorganized during the year. The outside sales forces were re-grouped into three sectors, each consisting of businesses and institutions with similar telecommunications needs. In each sector is a group dedicated to selling new services and a group servicing existing systems.

Cincinnati Bell people

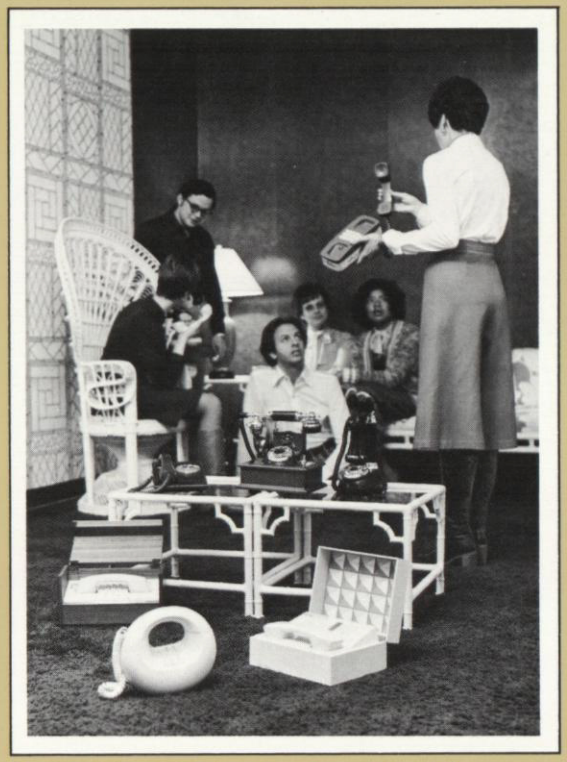
The third and final wage adjustment in the 1974 agreement with the Communications Workers of America was effective in August. It represented an increase of nearly eight percent in total labor costs. The agreement will continue in effect until August 6, 1977.

All goals and timetables in our approved Affirmative Action Program were met in 1976. The program is aimed at facilitating the movement of qualified women and minority groups into better jobs. An Affirmative Action Program for the handicapped was also established during the year.

The Company fully intends to continue meeting Equal Employment Opportunity targets and the requirements of the Occupational Safety and Health Administration.

Financing

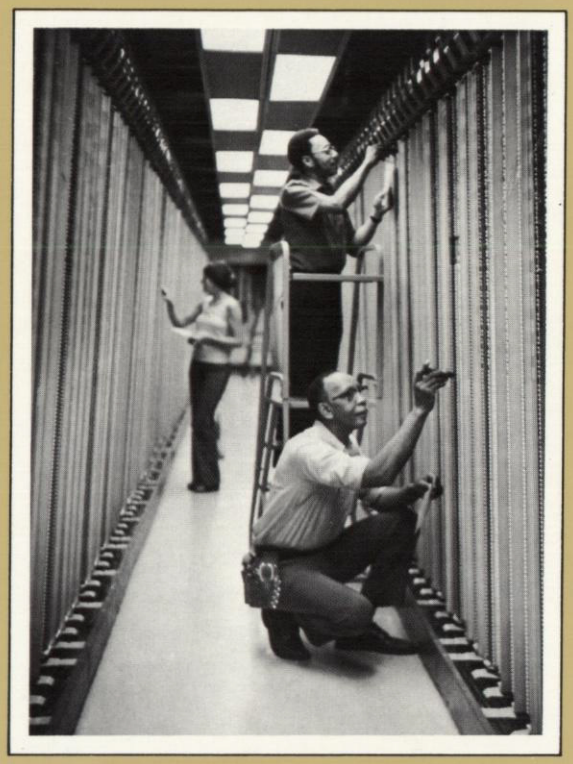
A new Share Owner Dividend Reinvestment and Stock Purchase Plan went into effect with the January 1977 dividend payment. The new Plan replaces the



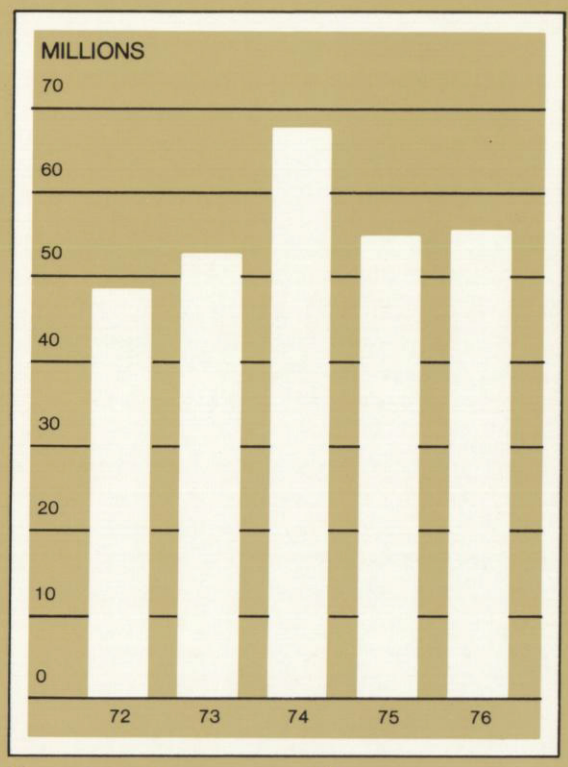
Design Line telephones, some of which are shown foreground, are the main attractions at Phone Parties.

One of the first Dimension PBX systems was installed for Wilson Freight Company. The console attendant is Norma Nusekabel.

*Trademark



Framemen Sam Brown, Ed Grizzard, on ladder, and Linda Insko complete the wiring changes required in the conversion to an Electronic Switching System in the Avondale switching center.



Construction expenditures

Automatic Dividend Reinvestment Plan. About 2,900 share owners, or 15.6 percent of the total, were enrolled in the new Plan at year end.

The Plan is being administered by the Company. It provides for the use of 335,000 authorized but unissued Cincinnati Bell common shares instead of shares acquired in the open market or by private purchase. The broker's commission and agent's service charge therefore have been eliminated.

In addition, the Company's Savings Plan for Salaried Employees was modified to permit the Plan Trustee to purchase up to 65,000 authorized but unissued Cincinnati Bell shares as well as shares acquired in the open market or by private purchase.

Together these two plans should have a favorable effect on the ratio of debt capital to total capital. At year end our capital consisted of 45 percent debt, seven percent preferred stock and 48 percent common stock equity.

Rate activity

Rate proceedings on our Ohio application to reprice services are well underway, and we hope to have regulatory decisions soon.

Applications were filed in Ohio and Kentucky in November 1975. The increases sought would produce additional annual revenues of $35.1 million from Ohio operations and $6.3 million from Kentucky.

Included in the Ohio filing is a request for authorization of a trial of Measured Rate Service. If approved, the trial would be conducted in a specific central office area for a 12- to 18-month period.

Measured Rate Service is a new pricing concept for basic telephone service. The monthly charge for service would depend on the number of calls made, the length of conversation, calling distance, and time of day. This system is designed to relate charges to usage and to give customers more control over the costs of their telephone service.

Increased interstate toll rates were placed in effect by AT&T in February 1976, resulting in additional annual revenues of approximately $1 million for Cincinnati Bell.

Ohio intrastate toll rates were increased in August. The new rates were sought by Ohio Bell, and were approved by the Public Utilities Commission of Ohio for all telephone companies in the state. Cincinnati Bell realized an annualized revenue gain of about $5.6 million from the order.

National telecommunications policy

The Communications Act of 1934 set a national goal for the telephone industry to provide efficient telecommunications service at reasonable prices to all the people.

To achieve that goal, the industry, with full support of its regulators, established pricing policies designed to keep residence rates as low as possible. Long distance, private line services, business services, extension, Trimline® and other special telephones, etc., have been priced sufficiently above their costs so that the difference can be used to help keep the price of basic residence service low.

In recent years however the Federal Communications Commission has made a series of decisions introducing what it calls "competition" into the telecommunications industry in the intercity private line service market and in providing terminal equipment — switchboards, telephones, and the like.

The very service items that have helped the telephone industry achieve its goal of Universal Service are now the most vulnerable to the artificial competition — more accurately, government allocation of the market — imposed by the FCC. Without the support of these items, residence telephone rates will rise sharply.

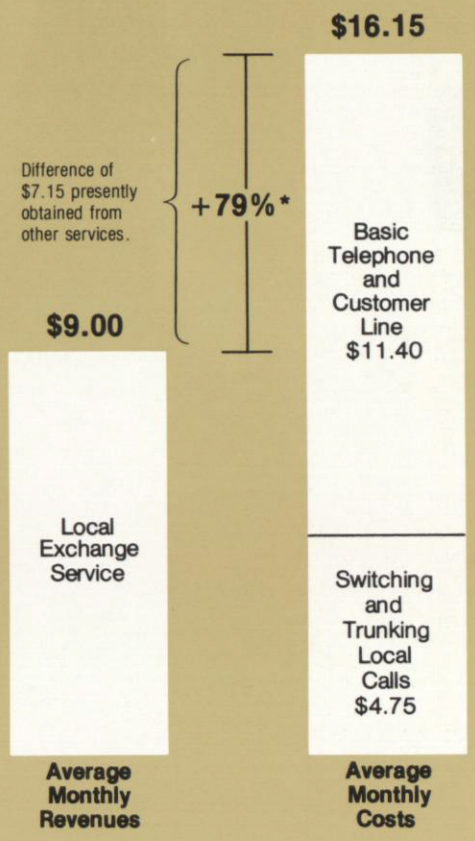
In addition, because of the integrated and interdependent nature of the telephone network, fragmenting responsibility for service among many competing companies will adversely affect the service all customers receive.

The current trends in national telecommunications policy are not in the public interest, and warrant review by the one body that should determine that policy — the Congress of the United States.

Accordingly, legislation has been introduced in both the House and Senate seeking to reaffirm the intention of Congress as expressed in the Communications Act of 1934.

Why Federal regulatory policies may drive up home telephone rates

Long distance calling and other services now cover substantial costs of facilities needed to provide local telephone service. To the extent this support is eroded because of regulatory policy, charges for local home phone service will be forced upward.



*These data include 10½% cost of capital. At the 11% currently in use for cost studies the increase required would be 84%. Over the 9½% to 10% cost of capital range approved by the FCC in Feb. 1976 (Docket 20376), the increase would range from 71% to 76%.
This chart is based on a study of residence service at the end of 1975. It is an update of a 1973 study submitted to the Senate Subcommittee on Antitrust and Monopoly in July, 1974. The earlier study showed 75% instead of the 79% shown above. Corporate overhead costs are not included; if they were, the 79% differential would be higher. The customer line and basic telephone are used for both local and long distance services.

Financial section

Cincinnati Bell Inc.

FIVE YEAR REVIEW

Dollars in Thousands Except Amounts Per Share

	1976	1975	1974	1973	1972
Revenues					
Local Service	$124,474	$118,548	$114,440	$ 98,594	$ 87,965
Toll Service	71,325	61,770	56,880	49,883	44,608
Other	4,999	5,769	4,848	3,950	3,883
	200,798	186,087	176,168	152,427	136,456
Expenses					
Operating	129,554	118,628	106,310	95,292	88,926
Federal Income Taxes	14,926	14,695	16,478	12,006	10,011
Other Taxes	21,314	19,050	18,278	16,108	13,765
Interest	12,985	11,890	12,413	11,345	9,646
	178,779	164,263	153,479	134,751	122,348
Net Income	22,019	21,824	22,689	17,676	14,108
Preferred Dividend Requirements	2,475	2,475	1,121	—	—
Income Applicable to Common Shares	$ 19,544	$ 19,349	$ 21,568	$ 17,676	$ 14,108
Earnings per Common Share	$2.79	$2.76	$3.08	$2.52	$2.02
Average Common Shares Outstanding	7,013,377	7,013,096	7,013,096	7,013,096	6,977,774
Dividends Declared per Common Share	$1.60	$1.60	$1.495	$1.34	$1.30
Taxes per Common Share	$5.17	$4.81	$4.96	$4.01	$3.41
Debt in Total Capital*	44.7%	45.4%	44.3%	51.3%	50.6%
Common Share Owners*	18,567	18,759	19,024	18,934	19,589
Employees*	4,924	5,134	5,188	5,274	5,335
Payroll and Related Costs	$101,500	$ 92,850	$ 83,644	$ 76,168	$ 69,380
Telephones*	1,079,359	1,034,508	1,003,247	974,462	934,249
Business	279,442	270,187	265,264	259,834	250,565
Residence — Main	479,463	467,995	459,340	450,438	437,739
— Extension	320,454	296,326	278,643	264,190	245,945
— % One-Party	91.6	90.5	89.2	87.8	86.2
Long Distance Messages	52,317,000	48,141,000	46,489,000	44,394,000	40,018,000
Average Toll Messages per Business Day	170,000	158,000	154,000	145,000	130,000
Construction Expenditures	$ 55,570	$ 55,092	$ 68,108	$ 52,752	$ 48,703
Plant Investment*	603,706	565,624	528,346	478,443	440,051

*At Year End.

TRANSFER AGENT
Cincinnati Bell Inc.
225 East Fourth Street
Cincinnati, Ohio 45202

REGISTRAR
The Central Trust Company
Fourth and Vine Streets
Cincinnati, Ohio 45202

CO-TRANSFER AGENT AND
CO-REGISTRAR
Morgan Guaranty Trust
Company of New York
30 West Broadway
New York, New York 10015

Management analysis of five year review

Earnings per common share increased 3 cents in 1976, as income applicable to common shares increased $195,000. Total revenues (including other income) were up $14,711,000 or 7.9 per cent while total expenses (including taxes and interest) increased $14,516,000 or 8.8 per cent. Earnings per common share for 1975 decreased 32 cents from 1974 and income applicable to common shares decreased $2,219,000. These decreases were principally the result of increased expenses and preferred dividend requirements totaling $12,138,000 which exceeded the increase in revenues of $9,919,000.

Total revenues (including other income) increased $14,711,000 in 1976 and $9,919,000 in 1975 for several reasons. There was growth in the number of telephones in service and in long distance calling volumes in both years. There were higher interstate long distance rates which resulted in increased revenues of about $1,100,000 in each year. Higher intrastate toll rates produced additional revenues of about $2,200,000 in 1976 and $300,000 in 1975. Sales of Directory Advertising increased in both years.

Operating expenses increased in 1976 by $10,926,000 and in 1975 by $12,318,000. Principal reasons for these increases were higher wages, fringe benefits and depreciation expense. Higher wages (including cost-of-living adjustments) and salaries accounted for about $3,245,000 of the increase in 1976 and $5,340,000 in 1975. About $3,136,000 in 1976 was attributable to higher pension accrual rates and improvements in other fringe benefits while the same costs increased $3,667,000 in 1975. Depreciation expense increased $2,711,000 in 1976 and $2,031,000 in 1975, reflecting larger plant investment in each year and higher depreciation rates in 1976.

Income taxes on operations increased $231,000 in 1976 and decreased $1,783,000 in 1975, reflecting changes in taxable income.

Other taxes on operations increased $2,264,000 in 1976 and $772,000 in 1975, largely as a result of increases in property taxes applicable to an expanding base of taxable plant. Gross receipts taxes increased $304,000 in 1976 and $330,000 in 1975. Social Security taxes rose $282,000 in 1976 and $253,000 in 1975, mainly because of statutory increases in the taxable wage base.

Interest expense increased $1,095,000 or 9.2 per cent in 1976 primarily because of the higher cost of debt.

Market and dividend information

The principal market where Cincinnati Bell voting securities, namely, common shares, are traded is the New York Stock Exchange. The high and low sales prices and dividends paid on these securities for each quarterly period during the most recent two fiscal years were:

1975	Quarter	1st	2nd	3rd	4th
	High	21⅛	21⅛	21	19⅞
	Low	18⅜	19⅝	19	18¾
	Dividend paid	40¢	40¢	40¢	40¢

1976	Quarter	1st	2nd	3rd	4th
	High	21⅞	21⅛	22⅜	24¼
	Low	19⅛	19¾	19¾	22
	Dividend paid	40¢	40¢	40¢	40¢

Report of Independent
Certified Public Accountants

TO THE SHARE OWNERS OF
CINCINNATI BELL INC.

We have examined the balance sheet of Cincinnati Bell Inc. as of December 31, 1976, and the related statements of income and reinvested earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements of the Company for the year 1975.

As described in note (h) of Notes to financial statements, net income for 1976 includes amounts resulting from interstate rate increases which are subject to investigation and possible refund.

In our opinion, subject to the final outcome of the rate matter discussed in the preceding paragraph, the financial statements (pages 12 to 19) present fairly the financial position of Cincinnati Bell Inc. at December 31, 1976 and 1975, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

3800 Carew Tower
Cincinnati, Ohio
February 14, 1977

Coopers & Lybrand

Balance sheets

ASSETS

	Thousands of Dollars	
	December 31, 1976	December 31, 1975
TELEPHONE PLANT — at cost		
In service	$593,400	$558,215
Under construction	10,072	7,271
Held for future use	234	138
	603,706	565,624
Less: Accumulated depreciation	134,546	125,265
	469,160	440,359
INVESTMENTS — at cost	954	964
	470,114	441,323
CURRENT ASSETS		
Cash	877	1,015
Receivables — less allowance for uncollectibles:		
1976, $159,000; 1975, $153,000	26,180	23,426
Material and supplies	2,918	3,350
Prepaid expenses	529	372
	30,504	28,163
DEFERRED CHARGES	2,728	2,465
TOTAL ASSETS	$503,346	$471,951

The notes on pages 17, 18 and 19 are an integral part of the financial statements.

LIABILITIES AND CAPITAL

	Thousands of Dollars	
	December 31, 1976	December 31, 1975
EQUITY		
Preferred shares— at stated value (note b)	$ 30,000	$ 30,000
Authorized 1,000,000 shares; Outstanding 30,000 shares.		
Common shares — par value $12.50 per share (note c)	87,714	87,664
Authorized 10,000,000 shares; Outstanding 1976, 7,017,096 shares; 1975, 7,013,096 shares.		
Proceeds in excess of par value on common shares	7,353	7,305
Reinvested earnings — see page 15	94,937	86,696
	220,004	211,665
LONG TERM DEBT (note d)	172,077	172,199
CURRENT LIABILITIES		
Accounts payable	15,326	12,336
Taxes accrued	11,999	11,078
Advance billing and customers' deposits	5,450	5,064
Interest accrued	3,961	3,944
Dividends payable	3,424	3,424
	40,160	35,846
Debt maturing within one year (note e)	5,797	3,900
	45,957	39,746
DEFERRED CREDITS		
Accumulated deferred income taxes	46,612	36,418
Unamortized investment tax credits	18,027	11,496
Other	669	427
	65,308	48,341
LEASE COMMITMENTS (note f)		
TOTAL LIABILITIES AND CAPITAL	$503,346	$471,951

Statements of income and reinvested earnings

	Thousands of Dollars	
	Year 1976	Year 1975
OPERATING REVENUES		
Local service	$124,474	$118,548
Toll service	71,325	61,770
Directory advertising and other	5,474	4,711
Less: Provision for uncollectibles	1,040	920
Total Operating Revenues	200,233	184,109
OPERATING EXPENSES		
Maintenance	39,704	36,834
Depreciation	28,695	25,984
Traffic Principally wages of telephone operators.	10,955	10,858
Commercial Primarily costs of local business office operations.	8,213	7,582
Marketing	6,719	6,013
Accounting	8,743	7,860
Provision for pensions and other employee benefits (note g)	19,643	16,507
Services received under license contract	3,195	2,533
Other operating expenses	3,687	4,457
Total Operating Expenses	129,554	118,628
Net Operating Revenues	70,679	65,481
OPERATING TAXES		
Federal income (note a)		
Current	(1,786)	1,849
Deferred	10,048	8,842
Investment tax credits — net	6,664	4,004
Property, gross receipts, payroll-related and other taxes	21,314	19,050
Total Operating Taxes	36,240	33,745
Operating Income (carried forward)	$ 34,439	$ 31,736

The notes on pages 17, 18 and 19 are an integral part of the financial statements.

	Thousands of Dollars	
	Year 1976	Year 1975
Operating Income (brought forward)	$ 34,439	$ 31,736
OTHER INCOME		
Interest charged construction (note a)	653	2,198
Miscellaneous income and deductions — net	(88)	(220)
Income Before Interest Deductions	35,004	33,714
INTEREST DEDUCTIONS	12,985	11,890
NET INCOME	22,019	21,824
Preferred dividend requirements	2,475	2,475
INCOME APPLICABLE TO COMMON SHARES (note h)	$ 19,544	$ 19,349
EARNINGS PER COMMON SHARE (after preferred dividend requirements)	$2.79	$2.76
Based on average shares outstanding, 7,013,377 in 1976 and 7,013,096 in 1975.		
REINVESTED EARNINGS		
At beginning of year	$ 86,696	$ 78,567
Add — Net income	22,019	21,824
Deduct — Dividends declared:		
Preferred — $82.50 per share	2,475	2,475
Common — $1.60 per share	11,222	11,220
Miscellaneous — net	81	—
REINVESTED EARNINGS AT END OF YEAR	$ 94,937	$ 86,696

Statements of changes in financial position

Cincinnati Bell Inc.

Thousands of Dollars

	Year 1976	Year 1975
SOURCE OF FUNDS		
Operations		
Net Income	$ 22,019	$ 21,824
Add — Expenses not requiring funds:		
Depreciation	28,695	25,984
Deferred income taxes	10,194	9,115
Investment tax credits — net	6,531	3,646
Deduct — Income not providing funds:		
Interest charged construction	653	2,198
Total funds from operations	66,786	58,371
Financing		
Issuance of common shares	98	—
Issuance of long term debt	—	40,000
Total funds from financing	98	40,000
Change in working capital	3,870	(31,002)
	$ 70,754	$ 67,369
APPLICATION OF FUNDS		
Telephone plant	$ 56,843	$ 53,736
Dividends	13,697	13,695
Reduction of long term debt	122	119
Other — net	92	(181)
	$ 70,754	$ 67,369
The change in working capital is accounted for by:		
Increase (decrease) in current liabilities:		
Accounts payable	$ 2,990	$ (3,272)
Taxes accrued	921	(1,166)
Advance billing and customers' deposits	386	335
Interest accrued	17	711
Debt maturing within one year	1,897	(25,800)
	6,211	(29,192)
(Increase) decrease in current assets:		
Cash	138	27
Receivables	(2,754)	(1,453)
Material and supplies	432	(488)
Prepaid expenses	(157)	104
	(2,341)	(1,810)
Change in working capital, as above	$ 3,870	$ (31,002)

The notes on pages 17, 18 and 19 are an integral part of the financial statements.

Notes to financial statements

(a) **Accounting Policies** — The Company maintains its accounts in accordance with the Uniform System of Accounts prescribed for telephone companies by the Federal Communications Commission (the "FCC"). The financial statements reflect the application of the accounting policies described in this note and have been prepared in conformity with generally accepted accounting principles, which are consistent in all material respects with the accounting prescribed by the FCC, except for possible revenue refunds (see note (h)). Other policies are covered in note (g).

Interest Charged Construction — Regulatory authorities allow the Company to provide for a return on capital invested in new telephone plant while under construction by including Interest Charged Construction as an item of income during the construction period and also as an addition to the cost of the plant constructed. Such income is not realized in cash currently but, under the regulatory process, will be realized over the service life of the plant as the resulting higher depreciation expense is recovered in the form of increased revenues.

Depreciation — Provision in the accounts for depreciation (5.1% in 1976 and 1975 of the cost of depreciable plant in service) is based on straight-line composite rates. Depreciation for income tax purposes is provided on different bases and methods as explained under "Income Taxes" below.

Income Taxes:

(1) Under various accelerated depreciation provisions of the tax law, depreciation for income tax purposes on plant placed in service after 1969 is greater than the straight-line depreciation provided in the accounts. In addition, the Company has adopted for income tax purposes shorter depreciation lives than those used for financial statement purposes for certain plant, as allowed in income tax regulations of the Treasury Department. Provision is included in income tax expense for the deferred income taxes resulting from the use of accelerated depreciation and shorter tax lives.

(2) Provisions of the tax law allow for reductions in tax liability for certain construction expenditures. Such reductions, which are captioned "investment tax credits", are accounted for as operating tax expense in the year they occur and are amortized, principally as reductions in operating tax expense, over the life of the plant constructed.

(3) The Company's effective Federal income tax rate, as determined by dividing Federal income taxes by the sum of Federal income taxes and Net Income, was 40.4% in 1976 and 40.2% in 1975. The differences of 7.6% and 7.8% in 1976 and 1975, respectively, between the effective rate and the 48% Federal income tax statutory rate are attributable to the following factors:

	1976	1975
a. Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted for income tax purposes, net of related depreciation adjustments for current and prior years	4.5%	3.4%
b. Interest charged construction which is excluded from taxable income, net of related depreciation adjustments for current and prior years	.4%	2.5%
c. Amortization of investment tax credits over the life of the plant which gave rise to the credits. Such amortization reduced income tax expense for the years 1976 and 1975 by about $1,030,000 and $647,000, respectively	2.8%	1.8%
d. Other miscellaneous differences	(.1%)	.1%
Total	7.6%	7.8%

(b) **Preferred Shares** — The preferred shares have a stated value of $1,000 each, an annual cumulative dividend of $82.50 per share and may be redeemed at a premium of $41.25 per share commencing July 1, 1979 and at diminishing amounts thereafter. They are also subject to redemption through the operation of a five year sinking fund commencing July 1, 1980.

(c) **Common Shares** — During 1976 the Company issued 4,000 shares to the trustee of the Cincinnati Bell Inc. Savings Plan for Salaried Employees.

(d) **Long Term Debt** — Interest rates and maturities on long term debt outstanding at December 31, 1976, in thousands of dollars, were as follows:

4 1/2% debentures due 1993	$ 25,000
4 3/8% debentures due 2002	20,000
8 3/8% debentures due 2009	35,000
7 3/8% debentures due 2011	50,000
9.60% debentures due 2015	40,000
Other	2,077
	$172,077

(e) **Debt Maturing Within One Year** — The Company follows the practice of financing construction of telephone plant partially through interim debt (notes payable due in 12 months or less after issuance and advances from American Telephone and Telegraph Company), pending long term financing. In the Company's computation of ratios of debt to total capitalization (usually referred to as "debt ratios") for regulatory and other purposes, interim debt is included with long term debt. Amounts outstanding at December 31, in thousands of dollars, were as follows:

Notes Payable:	1976	1975
Trust Note	$2,897	$2,000
Bank Loans	1,000	100
Commercial Paper	300	1,300
Advances from American Telephone and Telegraph Company	1,600	500
Total	$5,797	$3,900

The weighted average annual interest rates for the trust note, bank loans and commercial paper outstanding at December 31, 1976 were 4.6%, 6.3% and 4.5%, respectively. The maximum amount of notes payable at any month-end during the year 1976 was $9,085,000 and the average amount outstanding during the year was approximately $4,849,000 at an average interest rate of 5.7%, computed by averaging the face amount of the notes payable each day of the year and dividing such average into the

aggregate related interest expense.

Advances, evidenced by demand notes, are not in practice required to be settled currently, although the Company may elect to repay them as a whole or in part prior to demand. Interest on advances is at a variable rate at all times equal to the lowest prime rate being charged on new borrowings by three designated New York City banks.

(f) **Lease Commitments** — Total rental expenses for the years ended December 31, 1976 and 1975 were about $3,313,000 and $3,126,000, respectively. At December 31, 1976 the aggregate minimum rental commitments under non-cancelable leases, in thousands of dollars, were as follows:

Year	Amount
1977	$1,594
1978	1,441
1979	1,144
1980	967
1981	919
1982-1986	2,338
Thereafter	96

(g) **Provision For Pension and Death Benefits** — The Company has a noncontributory plan covering all employees and providing for service pensions and certain death benefits. The Company has an accrual program under which actuarially determined regular payments are made to trust funds that are irrevocably devoted to service pension and death benefit purposes. The total provision for these service pensions and death benefits, including amounts charged to construction, was $13,285,000 in 1976 and $11,677,000 in 1975, which represented 17.0% in 1976 and 16.0% in 1975 of salaries and wages. Amendments to the Plan, effective January 1, 1976, adopted pursuant to the 1974 union contract, which provide for improved benefits for all employees, and changes made in compliance with the Employee Retirement Income Security Act of 1974, increased pension accruals in 1976 by about $393,000. Based on the latest actuarial valuation, adjusted to reflect those benefits which became effective January 1, 1977, the Company estimates that the actuarially computed value of vested benefits exceeded the cost of trust fund assets by about $13,006,000. The accrual program contemplates that there will be available in the funds amounts sufficient to provide benefits as stated in the Plan.

(h) **Earnings Subject To Possible Refund** — Income Applicable to Common Shares for 1976 includes approximately $428,000 ($.06 per common share) resulting from interstate rate increases authorized by the FCC which were effective on February 29, 1976 and are subject to investigation and possible refund.

(i) **Department of Justice Antitrust Action** — In November 1974 Department of Justice brought a civil antitrust action naming American Telephone and Telegraph Company, Western Electric Company, Incorporated and Bell Telephone Laboratories, Incorporated as defendants, and the 23 Bell System telephone companies (including the Company) as co-conspirators but not defendants. This matter may not be resolved for several years. American Telephone and Telegraph Company has stated that it believes that the relief sought, which includes dismemberment of the Bell System, is adverse to the public interest and that it is confident that it has not been in violation of the antitrust laws and that the structure of the Bell System will remain basically unchanged. In the opinion of the Company, dismemberment of the Bell System could have adverse effects on its business.

(j) **Quarterly Financial Information (Unaudited)** — Subject to the outcome of the rate matter referred to below, all adjustments necessary for a fair statment of income for each period have been included.

	Thousands of Dollars			
Calendar Quarter 1976	Total Operating Revenues	Operating Income	Income Applicable to Common Shares	Earnings Per Common Share
1st	$ 48,104	$ 8,196	$ 4,301	$ .61
2nd	49,475	8,728	4,879	.70
3rd	50,554	8,678	5,246	.75
4th	52,100	8,837	5,118	.73
	$200,233	$ 34,439	$ 19,544	$2.79

Results for the second, third and fourth calendar quarters include approximately $140,000, $132,000 and $122,000, respectively, of Income Applicable to Common Shares ($.02 per common share for each period) resulting from interstate rate increases which are subject to investigation and possible refund. See note (h). Results for the fourth calendar quarter include a reduction of approximately $190,000 to Income Applicable to Common Shares ($.03 per common share) resulting from revised depreciation rates prescribed by the FCC, effective January 1, 1976.

(k) **Replacement Cost (Unaudited)** — In response to Securities and Exchange Commission requirements, the following figures compare telephone plant investment as shown on the balance sheet at December 31, 1976 with the approximate cost to replace its productive capacity at that date. They also compare accumulated depreciation at that date with the amount that would have been provided had past depreciation accruals contemplated such replacement costs. Additionally, they compare depreciation expense for the year ended December 31, 1976 with depreciation expense computed (using historic depreciation assumptions) on these estimates of replacement costs.

	Thousands of Dollars		
	As Stated	At Replacement Cost	Difference
Telephone Plant Investment:			
For which replacement cost has been determined	$589,357	$871,972	$282,615
Included at historic cost	14,349	14,349	—
Total	603,706	886,321	282,615
Accumulated Depreciation	134,546	256,984	122,438
Net Telephone Plant Investment	$469,160	$629,337	$160,177
Depreciation Expense	$ 28,695	$ 40,060	$ 11,365

These replacement cost figures are theoretical, based on the assumptions that, as of December 31, 1976: electronic switching systems would replace all electromechanical switching systems; most other telephone plant would be replaced in accordance with present replacement practices; and building space would be reduced because of the use of electronic switching systems. Certain telephone plant categories are included at historic cost: principally land, telephone plant under construction, and telephone plant held for future use.

The difference between historic and estimated replacement cost of net telephone plant investment does not represent additional book value for the Company's stock. The above replacement cost is an approximation of the amount of capital that could have been required were the Company to have replaced the entire productive capacity of such plant on December 31, 1976. Replacement actually will take place over many years and the funds needed will be derived from sources similar to those available during 1976.

Depreciation expense based on an estimate of replacement cost also is a theoretical figure and not deductible in determining income tax expense. The excess of depreciation on replacement cost over that determined on historic cost is a measure of the extent to which current operations have not been making provision for the higher replacement cost of present plant capacity. Such provision, if made, would provide funds which would be used in lieu of funds from other sources for plant construction.

It would be unrealistic to impute a reduced net income by the difference between depreciation based on historic cost and that based on estimates of replacement cost. New plant is likely to provide largely-offsetting additional revenue-generating services and operating efficiencies.

Additionally, replacement of plant will take place over many years. It is true, however, that the earnings of the Company must be high enough to provide some equity capital from reinvested earnings and to attract additional debt and equity to provide funds for any replacement cost in excess of depreciation accruals based on the historic cost of the plant.

Directors

■ CHARLES M. BARRETT, M.D.
President, The Western and Southern Life Insurance Company; Professor Emeritus, College of Medicine University of Cincinnati

ALBERT T. BONNICK
Vice President and Comptroller of the Company

□ RICHARD T. DUGAN
President of the Company

□ PHILIP O. GEIER, JR.
Retired; director of various corporations; former Chairman of the Board Cincinnati Milacron Inc. (manufacturer of process equipment and systems)

□ ■ DWIGHT H. HIBBARD
Vice President of the Company

▨ FRANCES JONES POETKER
Owner and Operator, Jones The Florist

■ MORLEY P. THOMPSON
President, D. H. Baldwin Company (financial services and manufacturer and retailer of musical instruments)

▨ DWIGHT J. THOMSON
Director and Special Assistant to the President Champion International Corporation (manufacturer of lumber, plywood, paper and related products)

□ ▨ RICHARD E. WAGNER
President, Pepsi-Cola Bottling Company of Cincinnati

□ WILLIAM J. WHITTAKER
Former President of the Company

Officers

RICHARD T. DUGAN
President

ROBERT H. ALLEN
Vice President - Secretary and Treasurer

ALBERT T. BONNICK
Vice President and Comptroller

DWIGHT H. HIBBARD
Vice President

WILLIAM W. VICTOR
Vice President

Directors emeritus

PAUL W. CHRISTENSEN
Former Chairman of the Board The Cincinnati Gear Company

DAVID M. FORKER, JR.
Former Chairman of the Board The William Powell Company (manufacturer of valves)

JOSEPH B. HALL
Former Chairman of the Board The Kroger Company (chain food stores)

BAYARD L. KILGOUR, JR.
Former Chairman of the Board of the Company

□ Members of the Executive Committee
Other directors serve as alternate members

▨ Members of the Audit Committee

■ Members of the Employee Benefit Funds Committee

Cincinnati Bell

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